Community Development Financial Institutions Fund
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Good morning and welcome to Washington, D.C. It gives me great pleasure to be here to represent the CDFI Fund and the Department of the Treasury to address the Coalition of Community Development Financial Institutions.

I have been on the job 131 days – hey, who's counting! I have the best job in Washington. There is no other place in Treasury that gives away money. We even get to allocate tax credits, which reduce the amount of money collected by our colleagues at the IRS. I stand here before you today to share nothing but great news!

Thank you, Ernest Skinner (Citigroup), for that kind introduction.

I have been invited to share my vision for the Fund and to talk to you briefly about the New Markets Tax Credit Program. You have an exciting agenda and I hope to be with you over the next two days. I am most interested in the discussion around your theme, "CDFIs Making an Impact." Impact and performance measures are major initiatives of the Fund. I am pleased to know that it is a focus of yours. We are constantly asked to provide and share data on the impact you, CDFIs, have in the financial services marketplace, in the markets you serve, and the specific, targeted impact you have in our nation's economic recovery. Over the next 15 – 20 minutes, I will share with you the Fund's goals and then leave time for us to discuss these plans and allow me to get your insight in a Q & A session.

First, let me talk vision and change. As you know, our vision at the Fund is to have an America in which all people have adequate access to credit, capital, and affordable financial services.

We, at the Fund, have a fresh perspective! A new look! A recast organizational structure! And a keener focus on you, the customer! And we have several new initiatives to present.

Our new look is bold and blue! The Fund's Public Affairs team has redesigned our outreach materials, website and presentation documents. They even took over my PowerPoint slides.

We want the quality of our information to reflect the high standards of the organizations we service. Our information should easily describe our programs and application requirements. You will even have a pickle head director greeting you [on the website]. The information should be presented in a way that's useful to you, and to help you raise equity and other funds for your organizational needs. Our website and Help Desk should be places you know you can visit with confidence for good, reliable information about Fund programs, and about our industry's progress. This new website will be up and running by March 2002.

We have a new organizational structure that is designed to place higher accountability on the Fund to complete application reviews, make award obligations, and close and disburse awards in a more timely manner. In October, I spoke at the NCCA's annual conference and promised, that with your assistance, we could cut the amount of time it takes to make, close and disburse an award by half. I meant that promise and the Fund's re-structure is but one of a number of important steps along the way to achieve this goal.

We are not mission driven if it takes us two years to get our money on the streets. We can do better – but only with the help of all of you. I am pleased to report that the ideas for the process improvements that I will describe are coming from the Fund's staff itself. They are intimately familiar with the Fund's programs and which of our processes can be redundant. We are working together to find ways to improve our delivery of CDFI Fund resources.

The programs of the Fund will be under the supervision of Fred Cooper, recently named as my Deputy Director for Policy and Programs. His is a critical role to the new re-organization. There are four units working under Fred.

Depository Institutions Function:

The Depository Institutions function will manage the Fund's strategies involving regulated financial institutions such as banks, thrifts and credit unions. The Bank Enterprise Award (BEA) Program is the current flagship program operated by this function. This function will be positioned to potentially take on more program responsibilities as the Department of Treasury expands its financial literacy campaign with such programs as First Accounts or Individual Development Accounts. This unit is currently reviewing the BEA Program and considering a major overhaul of the program that may leverage the Fund's resources more directly with banks, thrifts and other certified CDFIs in a more targeted fashion.

Program Operations Function:

The most significant shift in the Fund's resources will occur in our Program Operations function. Nearly all the Fund's advisors and program analysts will be grouped within this function and organized by geographic region, with each analyst reporting to a Regional Advisor. Three regional advisors will be named for the newly defined East, Central and West regions.

The primary responsibilities of the program analysts will not change. Our goal is to expedite the completion of certifications and the processing of award recommendations up to $200,000. Analysts will continue to work across program lines and will play leading roles in processing Core, SECA, NACTA, BEA and NMTC applications.

With the introduction of our new staffing model, we are going to place more reliance on you, the CDFIs, to submit applications that are complete---for funding as well as for certification and re-certification. We must limit the number of applications that are conditionally approved.

The Fund is at a crucial junction in its history. To date, in an effort to accommodate the developing needs of the industry, we have not held steadfast to many of our requirements and have permitted the closing period for funds disbursement to be protracted.

It's at the 12-month point that important decisions about awards must be made. If we determine that an award will not close within our two-year budget cycle, for whatever reason, we can decide to de-obligate that award and re-program those dollars elsewhere. In essence, we get two years to disburse or re-program. At the end of year five, all money not disbursed is returned.

We fully recognize that for this new process to work, we must do our part and make quicker award decisions. You, on the other hand, must do your part, and provide complete documentation, and sign and return award packages more timely and thoroughly. You will witness tighter management controls of our pipeline and less tolerance for procrastination on both sides – CDFI staff and Fund awardees.

Our new structure will allow us to successfully integrate the New Markets Tax Credit (NMTC) Program within the existing operations without an increase in the number of new employees in FY 2002.

The New Markets Tax Credit Program is designed to help spur economic growth in urban and rural communities across the country. Briefly, here's how NMTCs will work:

- A Community Development Entity (CDE), certified by the Fund, applies for an allocation of NMTCs.
- The CDE uses its allocation of NMTCs to raise equity from private investors.
- Individual or corporate investors can receive NMTCs worth 39% of the invested amount over the life of the credit.
- Investors need to make their investments in a CDE, certified by the CDFI Fund.
- The proceeds from these investments must be made in Qualified Low-Income Community Investments (QLICIs).
- $15 billion in tax incentives will be available over the next six years. We expect to allocate up to $2.5 billion in NMTC in calendar year 2002.
- If you have not done so, you should be completing applications for certifications. As CDFIs, it is a simple online registration.
- In seminars later today and tomorrow, Fund staff will discuss the advantages of for-profit and not-for-profit CDE certifications.

Financial Strategies & Research Function:

I have saved one of the other important program functional changes made at the Fund last so that we can move into a discussion about performance and impact measures. We have placed the responsibility for the development of meaningful performance and impact measures within our FS&R unit. This function will enhance the Fund's ability to perform research, portfolio analysis, and market analysis to measure the availability of financial services in underserved markets.

We will use the work of the FS&R unit to guide the Fund's use of its limited resources. FS&R will work closely with our Compliance Monitoring and Evaluation unit to help assess the sustainability of the Fund's programs and operations. We expect this unit to work closely with the industry's various trade associations to help us build a model for measuring community impact.

Let me share with you another one of our major operational initiatives – enhancing our compliance monitoring program. As some of you may know, the Fund's overall performance is subject to the general guidance set forth in the Community Development Banking and Financial Institutions Act of 1994, which established the Fund.

In a 1998 report completed by the GAO on the Fund's systems, it was recommended that the Fund review its assistance agreements and establish procedures to encourage the greater use of accomplishment measures. To encourage the use of accomplishment measures, GAO recommended that the Director waive sanctions for accomplishment measures beyond the awardees' control – such as economic conditions – while retaining sanctions for activity measures within an awardee's control.

Now, I bet your ears perked up on the recommendations for waiving sanctions – no way! Actually, the recommendation was to waive sanctions on measures "beyond the awardee's control." Now, here is where I imagine we can have great debate. Can you control volume or is that a function of the economy and other external factors? Have we, the Fund, micro-managed performance goals?

I'll answer these questions. Yes.

Currently, the Fund has over 200 awardees listed as non-compliant. These compliance issues range from technical (such as late or no current reports) to substantive, where several key performance measures are rated below expectations or unacceptable.

I also understand that, currently, if you are deemed to be "below expectations" on just one of several goals, this too can result in being rated as noncompliant. Also, it is clear that in many instances we have you tracking output numbers and not telling us about true impact.

Allow me to illustrate this point with one case study.

I reviewed the assistance agreement of one awardee engaged in micro-lending. Its goal is to increase the total number of micro loans disbursed to members of the awardee's low-income targeted population. First, it is impressive that it plans to make small business loans, in amounts of $25,000 or less, to low income persons. For the first reporting period, we negotiated volume to increase two-fold over the awardee's baseline period. The difference between a "satisfactory" rating and being tagged non-compliant is nine loans for the first reporting period. By the end of FY 2005, we expect the organization's volume to grow from an annual average of 21 loans to 266 loans in five years. Forty loans now separate this CDFI from "satisfactory" to non-compliant performance, let alone we expect a 13-fold increase in volume.

Wow, that sounds impressive. But is it realistic? Now our argument at the Fund is that these goals were based on your comprehensive business plan, submitted as part of your funding application. What is impressive is that 21 loans or 266 business loans were made to low-income individuals and I'm left to assume that these loans were made under innovative and flexible guidelines. Now hearing this profile, what difference or impact have you had in your targeted community? That is what Treasury Secretary Paul O'Neill and members of Congress want to know.

The question for the management team at the Fund is simply this: Are we measuring the right desired outcomes? In the micro-enterprise example, we can break this down into four key measures (Controllable and Non-controllable): 1) Portfolio Sustainability, 2) CDFI Self-Sufficiency; 3) Expanded/Stable Economy; and 4) Prosperous America.

- **Portfolio Sustainability**: At the Fund, we will need to create a reporting mechanism that explains the types of lending you do and why it's unique and distinct from what other more traditional lenders provide. We then need to answer whether or not the CDFI can sustain this level of lending from an asset quality, cost and portfolio liquidity standpoint. You will begin to see deeper analysis on the quality of your loan portfolio, sources and cost of funding from the Fund over the years to come.

  The CDFI in my example is targeting low-income individuals for business loans up to $25,000. The underwriting premise is that low-income persons lack the level of wealth to provide collateral as secondary and tertiary sources of repayment.

  Obviously, asset quality is the key to sustaining this level of lending. Another factor for portfolio sustainability is the source and cost of funds for this product type. How does this awardee fund its loan pool(s) – loans from institutional investors/lenders or from cash reserves developed from equity fundraising drives?

- **CDFI Self-Sufficiency**: Expanding the capacity of CDFIs is part of our mission. This capacity also needs to be measured by your sources of funds for both your operating and lending operations.

  In the case of our micro-lender, what happens to this entity as an ongoing concern if program income (interest and fees) does not exceed operating costs? Should the Fund be concerned about the variety and source of funding for major operating expenses to ensure the availability of this CDFI in the community?

  Yes, we should. In the future, you will likely see this analysis enhanced as part of our awards evaluation process and during the compliance monitoring period when certain financial soundness covenants are not met. We will also attempt to address the degree that CDFIs have reached of levels of self-sufficiency in their program operations.

- **Expanded or Stable Economy Analysis**: One of the things that we must do better at the Fund is to quantify and qualify underserved, distressed and target markets. Further, our analyses should help us understand why a level of basic financial services is lacking in these target markets. As we dig deeper, we plan to give preferences to areas and states with greater needs.

  We may achieve this by setting aside funds, like our Native American CDFI Technical Assistance or NACTA initiative. Or, we could simply offer bonus points during the awards evaluation process for those CDFIs serving areas or targets with greater needs.

  For example, when we looked at areas of the country with high concentrations of low-income populations and gave various states a ranking by the percent of low-income families or families living in poverty, we found that 0 of 5 and only 2 of 10 states with the highest percentage of low-income families ranked among the highest recipients of CDFI Fund awards.

  In the short run, much of our market analysis will be transparent to CDFIs. You will likely begin to see changes in our NOFA process or awards criteria as we gain greater comfort in the use of our market analysis to drive the Fund's resources.

- **Prosperous America**: The one goal that most strongly ties the Fund to the Department of Treasury is the one where our efforts in support of you achieves an economic development mission that leads to a more a prosperous and stable America. Our market and needs analysis model explained earlier will help to demonstrate how the Fund is market driven and through you, helps to stimulate the economy of our nation's distressed areas. Our plan to measure your accomplishments is an important part of this strategy.

Now that I have discussed four areas of desired outcomes that the Fund aspires to report – Portfolio Sustainability, CDFI Self-Sufficiency, Expanded or Stable Economy, and Prospering America – the question you are likely asking is, how will this affect you.

First, in many instances, we spend a great deal of time negotiating performance measures on the front end only to have them amended later during the awards monitoring period when your comprehensive business plan or other circumstances have changed from what you initially projected. I believe this method is inherently flawed.

The Fund should know the set of key ratios for managing a successful CDFI program. We are beyond the "touchy/feely" stage. Our funding programs are highly competitive and are over-subscribed. We are at the point where our database of over six years of CDFI financial and performance data should help drive the development of meaningful financial soundness covenants and performance goals.

Our Compliance Monitoring program will begin to take on a more sophisticated approach. Our goal is to measure compliance based on performance and capacity to reach distressed markets, not merely on your performance to a five-year business plan that gets outdated after one year. Or, for that matter, a plan we know is outdated by the time you get through our two-year awards disbursement process.

The point I want to make is that we are now at the stage where it is essential that we be able to measure the true impact of CDFIs in building community wealth for our nation's financially underserved and economically distressed areas.

One of the other significant changes you will see at the Fund over the next several years will be in our Compliance Monitoring Program. We are embarking on a pilot project to institute the Fund's **PLUM** rating system. This system will measure Performance or Community Impact; Leverage and Solvency analyses (or CDFI sustainability); Underwriting or portfolio loan quality; and finally, a Management rating that will assess the capacity of human resources **– PLUM** (Performance, Leverage, Underwriting, Management).

This score will rate CDFIs "for the fruits of their labor." **PLUM** will be our version of a regulated bank or thrift's CAMEL rating.

This new approach in compliance monitoring will not be an easy task. To accomplish this vision will require the close working relationship between the Fund, you individually and the industry as a whole in building this model.

Let me close my remarks by summarizing our key initiatives:

1. The Fund has been redesigned to streamline operations.

2. The Fund plans to strengthen its use of Financial Soundness Covenants for compliance purposes and limit the use of performance goals to industry analyses and peer group performance in determining impact.

3. The Fund views the CDFI Common Data Project as a useful tool in designing community impact analysis as the CDFI industry lacks conformity in product offerings.

<u>Conclusion:</u>

The Fund is initiating a great number of changes. These changes reflect the organizational maturity of the Fund and of the CDFI industry. The Fund is poised to better connect our nation's distressed and underserved markets with resources needed to increase economic health. We can achieve these changes and fulfill the goals described with your help. If the CDFIs do their share, the Fund will do what it needs to fulfill its end of the bargain. It is a partnership about which I am very excited.

I know that I have shared a lot of information with you in a very short period of time. I wanted to give you a sense of the hard work and depth of initiatives that are underway at the CDFI Fund. I am grateful to have the energies and commitment of a bright and dedicated staff. We have much on our plates and we wanted to share as much as we could with you for feedback.

Thank you so much for your attention. At this time, I would like to hear some thoughts and comments from you.